Federal Housing Assistance Emphasizes Loan Guarantees

Continuing the trend of recent years, the volume of home mortgage loan guarantees by Federal agencies is rising while direct lending is falling. Loan guarantees are outdistancing direct loans in USDA's main housing program (Section 502), which assists in the purchase of single-family homes.

Federal housing programs continue down the path of greater economy by reducing the size of many of the more heavily subsidized programs and lowering the subsidies provided to each program participant. While these direct lending programs continue to shrink, the much less costly mortgage guarantee and insurance programs are growing. Such programs charge insurance fees, which cover a substantial portion of loan losses and operating costs. Direct lending programs are usually targeted to lower income borrowers than are loan insurance programs. While housing is a tool for economic and community development, the net impact on rural economies of shifting the program focus from direct to insured loans is unclear. In addition to the activities of Federal agencies discussed below, two government-sponsored enterprises (GSE's)—the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—are major players in home mortgage financing. Both GSE's have initiatives to increase their purchases of rural mortgages.

Home Ownership Grows and the Housing Sector Is Healthy

The majority of American families (65.4 percent) own their homes. Home ownership is highest in rural America, where the nonmetro home ownership rate averaged 73.5 percent for 1996, compared with a similar 72.7 percent for metro suburbs and 49.7 percent in central cities. Home ownership for each of these areas is at its highest level in over a decade, with both nonmetro and suburban levels rising at least 0.7 percent in both 1995 and 1996.

The housing sector was fairly robust in 1996, whether measured by home sales, housing starts, or building permits. Nationally, there were record sales of existing homes (4,086,000) and all homes (4,842,000), despite some downturn in the fourth quarter. Permits for the construction of 234,100 housing units in nonmetro places during 1996 was 8.5 percent above the 1995 level, while the metro level of 1,196,800 was up 7.2 percent.

Mobile homes are a significant source of rural housing. In 1993, 47 percent of the 5.655 million mobile homes used as residences were in nonmetro areas. Nearly 13 percent of nonmetro households live in mobile homes compared with 4 percent of metro households. Mobile home sales of 311,000 for 1996 were at their highest level since 1974. Fifty-eight percent of these homes were in the South, which continues to receive over half of all mobile home shipments. The average price of a new mobile home in 1996 was $36,300, up 8.4 percent from 1995.

While a substantial minority of both rural and urban households benefit from Federal housing programs, these programs reach a smaller share of rural households. The 1993 American Housing Survey found that 17 percent of nonmetro and 26 percent of metro home mortgages were either from, or insured by, a Federal Government agency (fig. 1).

The Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) is primarily responsible for housing assistance and consequently provides the largest amount of home mortgage assistance, both in urban and rural areas. However, USDA's Section 502 direct and guaranteed program, administered by the Rural Housing Service (RHS), plays an important role, accounting for almost one-fourth of all Federal mortgage assistance to nonmetro households (fig. 1).

Section 502 loan guarantees are taking on an increasing importance in rural areas as the current emphasis of home ownership programs is to use guaranteed/insured loans from private lenders rather than direct loans. Since its start in fiscal year 1992, the volume of loan guarantees has increased each year, a trend that is expected to continue in fiscal year 1997. Over this same period, the amount of Section 502 direct lending has been declining. As a result, Section 502 guarantees are approaching four times the dollar amount of direct loans (table 1). It should be noted that the 1997 decline in direct lending is caused by increased market interest rates that in turn raised the amount of subsidy associated with each direct loan. Thus, the funding provided for interest subsidies could not support the lending levels anticipated when the budget was passed.

The subsidy to the typical government home mortgage program borrower has dropped with the declining number of direct loans, which usually employ such subsidy tools as reduced transaction costs, below-market interest rates, and relaxed lending standards, including smaller downpayment requirements. Additionally, the subsidy cost associated with each direct loan is less because borrowers are often charged higher interest rates, and a portion of prior subsidies may be recaptured.

While on a per capita basis urban areas receive more Federal funds for rental housing than do rural areas, the difference is much less than that for home owner programs. In fiscal year 1995, the largest programs for rental housing provided about $99 per capita in urban and $67 per capita in rural areas. By comparison, the major home ownership programs provided per capita amounts of $224 in urban and $67 in rural areas. While owner programs have a clientele base that includes many moderate income families, renter programs are almost exclusively focused on the low-income population. Renter programs operate either by subsidizing rents for those unable to afford adequate housing, or by promoting an increased supply of low-cost rental housing. Both approaches can be found in a single program, such as the RHS Section 515 program where financing costs are subsi-

Table 1

Summary of largest housing programs

Projected levels of Federal housing loan programs in 1997 are up from 1996 levels for guaranteed and insured loans, but down for direct loans

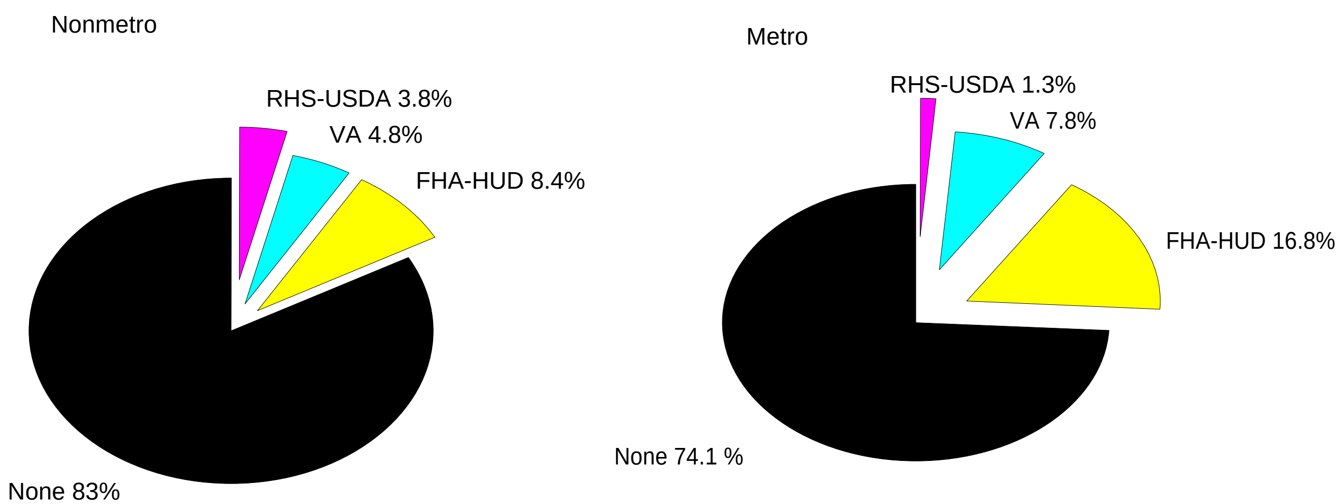
Program	Program level by fiscal year: 1996 actual	1997 projected	Change	Rural areas most affected by the program
	Billion dollars		Percent	
USDA/RHS				
Single Family Housing (Sec. 502)				
Direct Loans[1]	1.02	0.73	-28.5	(All Sec. 502) large metro fringe, Midwest & West, retirement counties.
Guarantees	1.70	2.70	58.8	Same as above.
Multifamily (Sec. 515)	0.15	0.15	1.3	Totally rural & nonadjacent, Northeast, West, commuting counties.
Rental Assistance	0.54	0.52	-3.0	Same as above.
VA				
Loan Guarantees	28.68	30.23	5.4	Urban nonmetro & adjacent, West (***not*** Midwest), retirement counties.
HUD				
FHA Single-Family Mortgage Insurance	65.77	71.15	8.2	Urban nonmetro, West.

[1]Includes $141 million in loans, paid for by $20 million from the Fund for Rural America.
Source: ERS calculations based on the Budget and Census's Federal Funds data.

Figure 1

Federal agencies and home mortgage lending, 1993

Smaller share of rural lending is federally insured or direct



Source: ERS tabulations from American Housing Survey for the United States, 1993.

dized in return for an agreement that units be rented to program participants at reduced rates. HUD is replacing housing subsidies that are tied to particular rental units for a long period of time with more flexible tenant assistance, which gives greater attention to housing vouchers, local control, and home ownership options. While HUD Section 8 vouchers play a larger role in urban programs, they are also used in rural areas. Although HUD operates the only voucher program, some voucher recipients are tenants in RHS projects.

Department of Agriculture (USDA) Loan Guarantees Are Increasing

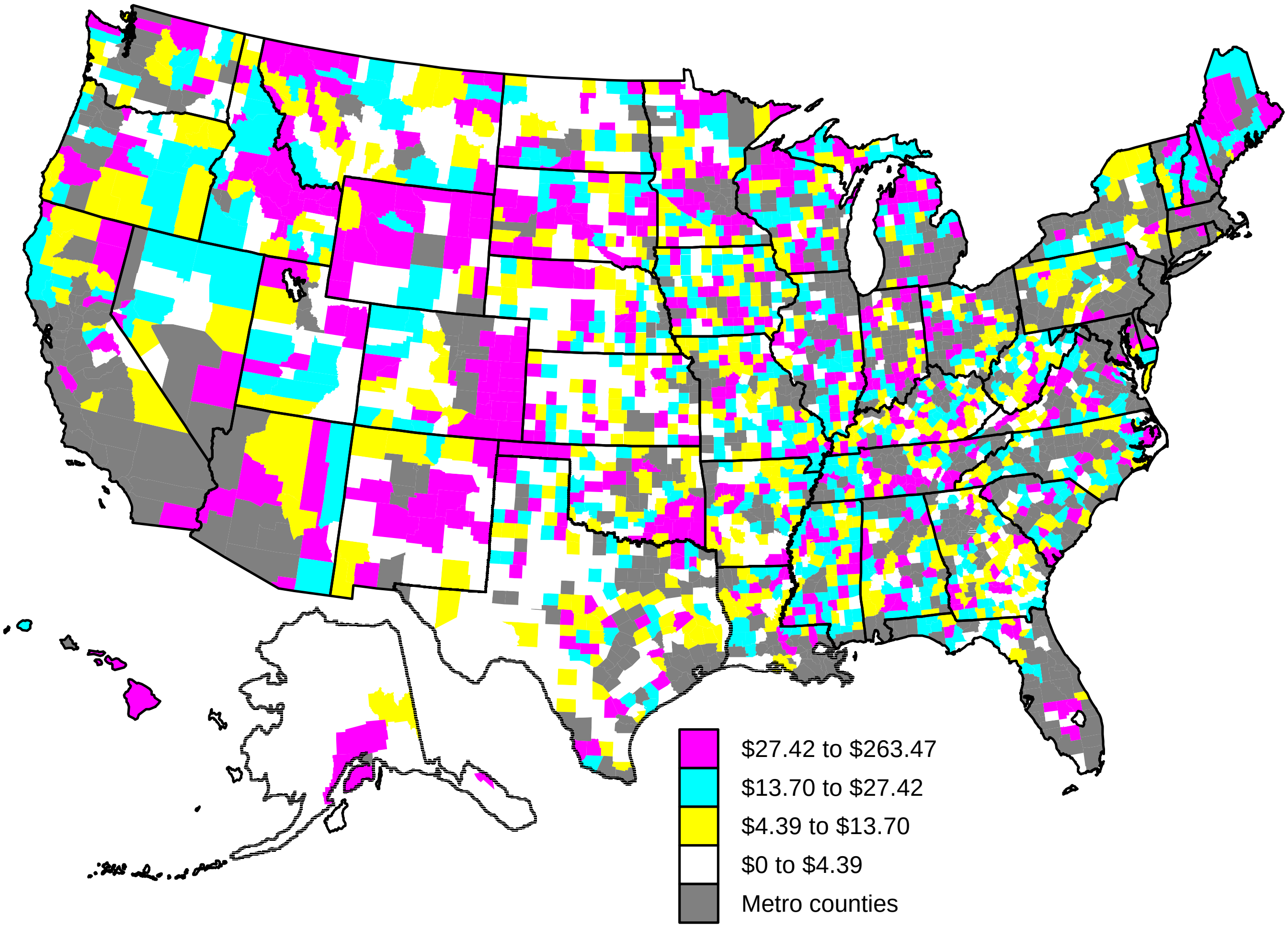
USDA's housing programs are administered by the Rural Housing Service (RHS), which was created out of the Farmers Home Administration (FmHA) in a 1994 departmental reorganization. RHS housing programs provide assistance in rural portions of both nonmetro and metro counties. The largest RHS housing program is Section 502 single-family housing, which constitutes over three-fourths of the agency's housing loan activity. New RHS lending in fiscal year 1995 split about equally between nonmetro (47 percent) and metro (53 percent) areas. Nonmetro counties with higher per capita levels of these loans were concentrated in upper New England, parts of the Mountain West, and scattered across the Midwest and Southeast (fig. 2).

The Section 502 program has changed considerably in the last 3 years. As discussed earlier, the direct lending share is falling, because most of this program's new activity comes from loan guarantees. In turn, since only direct loans carry a significant subsidy, per borrower program costs have fallen. Subsidy expenses on new loans have also been lowered by changes in program regulations that increased the effective interest rate on most direct loans. Subsidies on direct loans also rise and fall in tandem with movements in market interest rates. This is because the effective interest rates on most new direct loans are set without consideration of market interest rates. A major change planned for fiscal year 1998 aims to provide further cost savings to the Government mostly through lowering administrative expenses.

Figure 2

Per capita USDA nonmetro single-family housing loans, fiscal year 1995

The distribution is fairly even except for low levels in the Plains



Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

RHS is using loan leveraging programs to reach more low-income borrowers with its limited funds for direct lending. In addition to such programs with Fannie Mae and Freddie Mac, RHS has entered loan-sharing agreements with various public, private, and nonprofit entities. Under these arrangements, RHS makes a second-trust reduced-interest loan for a portion of the total financed amount, paired with a companion loan for the remaining amount. Unless the companion loan also carries a greatly reduced interest rate, this program cannot reach RHS's lowest income clientele. When the companion loan is a conventional market-rate mortgage, total mortgage payments by the borrower will be below those on a conventional loan, but well above those on a RHS loan of the entire amount at their minimum interest rate of 1 percent. Because RHS takes essentially all of the risk exposure for the combined loan, RHS's future loss rate may be higher than if RHS were the sole lender, because they are involved in more loans.

The RHS administers other housing programs for the same rural areas eligible for the Section 502 program. The largest of these activities in 1995 provided rental assistance for low-income tenants in RHS-financed rental housing, which averaged under $8 per nonmetro person. Though smaller than the total amount of mortgages guaranteed by RHS, rental assistance payments are the agency's most expensive program because the program involves only direct expenditures. In fact, the $524 million in estimated fiscal year 1997 budget authority is two-thirds of the total for all RHS loan and grant programs, exclusive of costs for salaries and expenses. Additionally RHS's Section 515 multifamily housing program provided financing of under $3 per nonmetro person for the construction, purchase, rehabilitation, or repair of low-income rental housing. The combined amount that nonmetro areas received from these two rental housing programs in fiscal year 1995 is about half of the $21 per capita of Section 502 loans. Although over two-thirds of such RHS rental housing assistance, both loan and grant, went to nonmetro areas, this was true for just under half of all Section 502 loans. Section 515 and rental assistance programs are expected to account for about 16 percent of RHS's total loan and grant activity for fiscal year 1997, while Section 502 lending will comprise 76 percent. Additional RHS programs include such activities as very-low-income home repair, self-help housing, and farm-labor housing. The largest increase in RHS programs was for mutual self help housing grants, with a fiscal year 1997 budget of $26 million, which doubled the previous year's level.

FHA Insurance Expands Dominant Role in HUD Housing Programs

HUD's main housing activity is FHA's single-family home mortgage insurance program, which provided $65.8 billion of mortgage insurance in fiscal year 1996, and is projected to top $71 billion in 1997. Only 6 percent of the amount insured in fiscal year 1995 was in nonmetro areas. These nonmetro loans were concentrated in the West and in counties that were more urbanized or had large numbers of retired persons (fig. 3). Loan levels were much lower in the more rural counties. Totally rural counties that were not adjacent to a metro area had only $19 of such loans per capita, compared with a nonmetro average of $48 and a metro average of $182. The nonmetro geographies of FHA and RHS Section 502 programs contrast sharply. For instance, there is much greater variation in the per capita level of FHA lending by various county classifications, and the Midwest had the lowest per capita levels for FHA and the highest for RHS. The largest housing program financed by direct outlays or grants was HUD's $18.1-billion Section 8 low-income housing assistance program, of which nonmetro areas received 13 percent. This multifamily housing program is undergoing substantial change as HUD's housing strategy moves away from long-term financing commitments for low-income rental housing.

The most important low-income housing issue is how to deal with the impending expiration of rental assistance contracts on approximately 1.8 million housing units that provide housing for 4.4 million persons. This issue has been building to a crescendo because of a late 1970's spike in the construction and rehabilitation of Section 8 housing under 15-year to 20-year contracts. Since 1995, expiring contracts have been renewed for a year at a time, meaning that each year a growing number of expiring 1-year contracts are added to expiring longer term commitments.

The future of HUD and its programs is still being debated, but major changes have already been made and others are in the works. Future HUD programs seem destined to be far fewer in number and much more flexible in how they are used. State and local governments will have much more control over what will likely be a reduced level of funding. There is a strong commitment to expanding the opportunity for home ownership to a wider audience and to reducing the role of large-scale low-income housing projects.

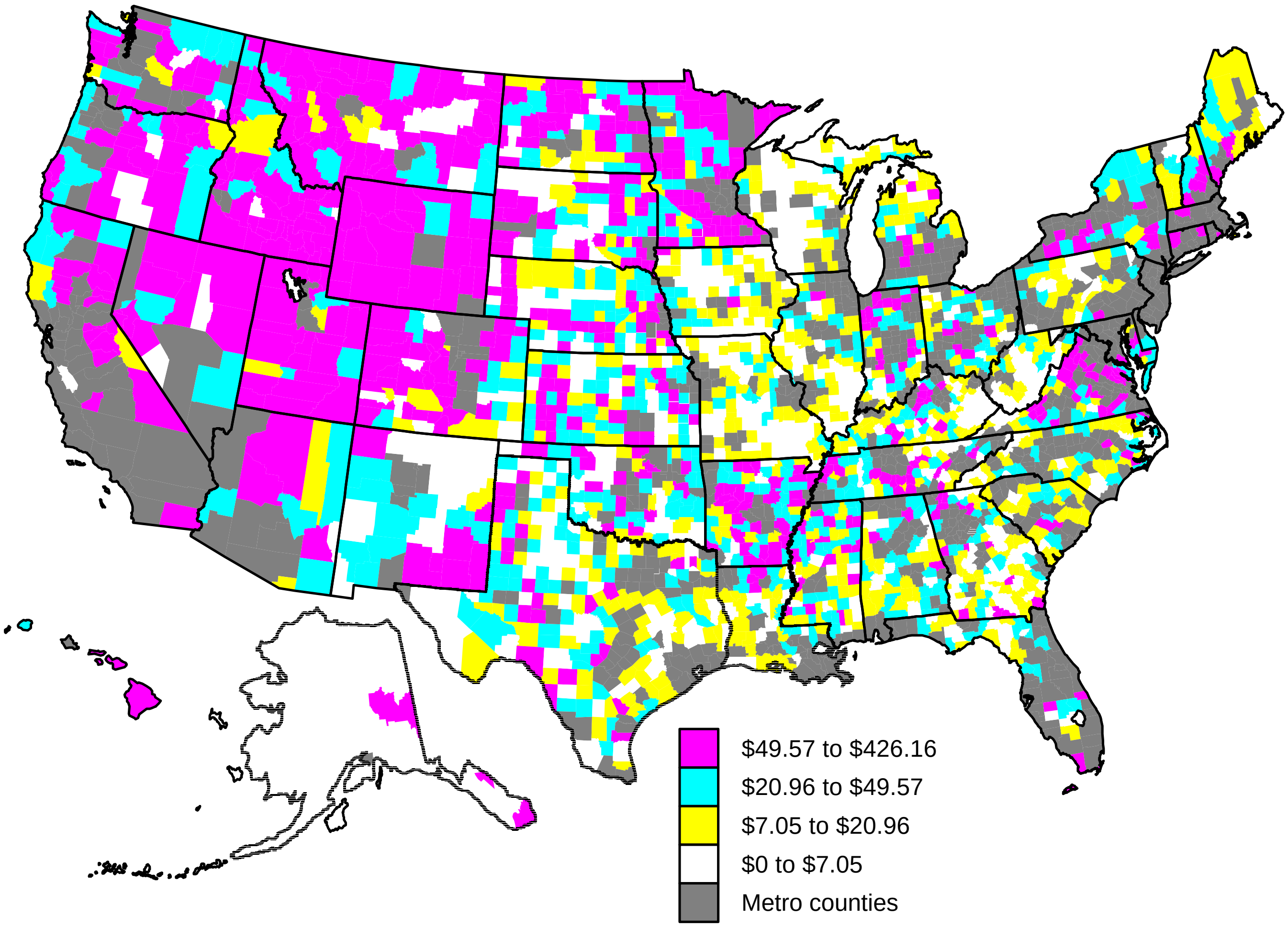
Department of Veterans Affairs (VA) Mortgage Insurance Concentrates in Urban Areas

VA housing loans are expected to total about $30 billion in fiscal year 1997, a 5-percent increase from 1996. About 11 percent of VA's housing program activity is in nonmetro areas. Nearly all of that is in the form of guaranteed loans. In 1995, rural areas received less than $18 per capita of such VA loans, half of that received by urban areas. VA nonmetro loan levels were highest in the most urban and adjacent counties ($20) and lowest in the most rural and nonadjacent counties ($9). By region, nonmetro lending was highest in the West ($31) and lowest in the Midwest ($12). VA guarantees cover loan losses

Figure 3

Per capita FHA mortgage insurance, fiscal year 1995

There is a heavy concentration in the nonmetro West



Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

that may be as much as 50 percent, but not more than $36,000 for loans up to $144,000. For larger loans, the guarantee amount can be somewhat higher.

At one time, the typical VA loan was available with no fee to the borrower, but now borrowers usually pay a fee that is a percentage of the loan amount. Fees are higher for certain loans, including those with smaller downpayments. Some special borrowers can receive the loan guarantee at no cost. In the past, the VA targeted direct loans to "rural areas where availability of private mortgage funds was limited." This is no longer true. Direct loans are now restricted to financing specially adapted housing assistance for certain disabled veterans. *[Jim Mikesell 202-219-0098, mikesell@econ.ag.gov]*